

Real Estate Strategic Outlook: Australia

Cap rate expansion shifts focus to rental growth

Interest rates are likely to be higher for longer

The Reserve Bank of Australia (RBA) has delivered one to two more hikes in 2026, as headline inflation spiked to 4.6% (March 2026). While most of this increase can be attributed to rising automotive fuel prices due to the Middle East Conflict and Electricity prices following an end to government subsidies, there remain pockets of momentum in Residential Rents and New Dwelling Purchase Construction Costs. The RBA remains hawkish with the expectation that inflation could remain elevated over the next 12-18 months, though largely contingent on the duration of the Middle East Conflict. Economic growth is likely to be a little weaker in the near term, though Australia remains the favourable in the APAC region. Most economists and major banks forecast one to two more rate hikes over 2026.

Rising cost of debt to place upwards pressure on cap rates

Most sectors have experienced moderate growth in capital values over the first half of 2026; however, we anticipate a softening in cap rates looking forward. 3yr swap rates have increased by 75bps over the past 6 months, while 10yr government bond yields are hovering around 5.0% (June 26), pressuring short-term financing and long-term pricing expectations (risk premiums). The Australian market could potentially see cap rate expansion between 10-50bps over the next two years, before moderating inline with the interest rate cycle. Rental growth is likely to mitigate much of the impact on capital values, though Retail and Industrial look more exposed. Cap rate movements are likely to be less pronounced in the Residential sector given the weight of capital, scarcity of product and strong underlying rental growth expectations.

Residential: Our top pick for the Australian market

The Australian Build-To-Rent (BTR) sector continues to transition from an emerging to an institutional asset class. By the end of 2026 there will be an estimated 21,096 operational BTR units nationally, with Melbourne reflecting 65% of the market share. While momentum in development activity is a positive for liquidity, Institutional BTR assets only reflect approximately 1% of the total rental supply, with the bulk provided by existing mum-and-dad stock. Proposed changes to negative gearing and capital gains tax (CGT) for newly purchased existing assets announced in the Federal Budget look to redirect capital flows towards new builds/BTR. Over the next 5 years we believe there will be greater pressure on institutional BTR to deliver rental supply to the market and with only 50% of projects currently funded, rental vacancy could tighten further driving stronger rental growth.

Sydney and Brisbane remain our top picks underpinned by challenged purchase affordability, lower rental vacancy and significant infrastructure investment.

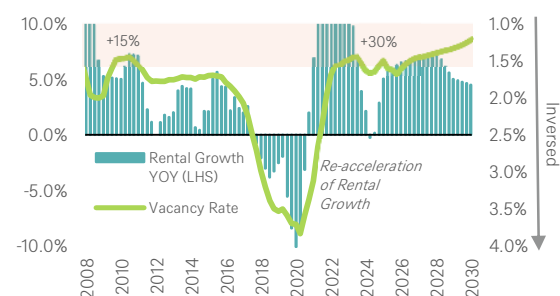
Office: Sydney and Brisbane markets better positioned

The Australian CBD office market fundamentals are well positioned to absorb a period of economic uncertainty. Net absorption has been positive over the 12 months to December 2025, as occupiers continue to favour newer, prime grade assets. Leasing options in core locations are becoming limited, leading to rental growth outperformance and improving incentives. The Brisbane market continues to be the standout performer recording double digit rent growth YOY, while Sydney presents a buy opportunity with prime grade assets at a 15% discount to peak valuations. While we anticipate cap rates could expand approximately 30bps over the short term, we believe the rental growth outlook is more favourable in Sydney and Brisbane with both markets likely to see vacancy improve over 2026.

Industrial: Short-term headwinds

The Australian Logistics market continues to experience a broad-based slowdown in leasing demand; however limited supply could provide some support. Occupiers have been cautious to start the year as higher fuel prices weigh on margins, particularly 3PL companies. Household spending is beginning to slow, which is likely to influence space requirements. Rising vacancies continues to weigh on incentives and subsequently effective rental growth, more pronounced in the Melbourne market. Rising vacancy could see weaker rental growth over the next 12-18 months, impacting capital values, though the Brisbane market is more resilient. Over the mid-to-the-longer term the supply pipeline is largely contingent on pre-commitments, which is likely to provide support to market vacancy and underlying rental growth.

Sydney Residential Vacancy vs Rent Growth*, 2026-2030f



Source: DWS, CBRE Research, SQM Research (Dec 25), *Units

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